MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to raise the three key ECB interest rates by 75 basis points. This major step frontloads the transition from the prevailing highly accommodative level of policy rates towards levels that will ensure the timely return of inflation to our two per cent medium-term target. Based on our current assessment, over the next several meetings we expect to raise interest rates further to dampen demand and guard against the risk of a persistent upward shift in inflation expectations. We will regularly re-evaluate our policy path in light of incoming information and the evolving inflation outlook. Our future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach.

We took today's decision, and expect to raise interest rates further, because inflation remains far too high and is likely to stay above our target for an extended period. According to Eurostat's flash estimate, inflation reached 9.1 per cent in August. Soaring energy and food prices, demand pressures in some sectors owing to the reopening of the economy, and supply bottlenecks are still driving up inflation. Price pressures have continued to strengthen and broaden across the economy and inflation may rise further in the near term. As the current drivers of inflation fade over time and the normalisation of our monetary policy works its way through to the economy and price-setting, inflation will come down. Looking ahead, ECB staff have significantly revised up their inflation projections and inflation is now expected to average 8.1 per cent in 2022, 5.5 per cent in 2023 and 2.3 per cent in 2024.

After a rebound in the first half of 2022, recent data point to a substantial slowdown in euro area economic growth, with the economy expected to stagnate later in the year and in the first quarter of 2023. Very high energy prices are reducing the purchasing power of people's incomes and, although supply bottlenecks are easing, they are still constraining economic activity. In addition, the adverse geopolitical situation, especially Russia's unjustified aggression towards Ukraine, is weighing on the confidence of businesses and consumers. This outlook is reflected in the latest staff projections for economic growth, which have been revised down markedly for the remainder of the current year and throughout 2023. Staff now expect the economy to grow by 3.1 per cent in 2022, 0.9 per cent in 2023 and 1.9 per cent in 2024.

The lasting vulnerabilities caused by the pandemic still pose a risk to the smooth transmission of our monetary policy. The Governing Council will therefore continue applying flexibility in reinvesting redemptions coming due in the pandemic emergency purchase programme portfolio, with a view to countering risks to the transmission mechanism related to the pandemic.

The decisions taken today are set out in a press release available on our website. A separate technical press release on the remuneration of government deposits will be published at 15:45 CET.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

The euro area economy grew by 0.8 per cent in the second quarter of 2022, mainly owing to strong consumer spending on contact-intensive services, as a result of the lifting of pandemic-related restrictions. Over the summer, as people travelled more, countries with large tourism sectors benefited especially. At the same time, businesses suffered from high energy costs and continued supply bottlenecks, although the latter have been gradually easing.

While buoyant tourism has been supporting economic growth during the third quarter, we expect the economy to slow down substantially over the remainder of this year. There are four main reasons behind this. First, high inflation is dampening spending and production throughout the economy, and these headwinds are reinforced by gas supply disruptions. Second, the strong rebound in demand for services that came with the reopening of the economy will lose steam in the coming months. Third, the weakening in global demand, also in the context of tighter monetary policy in many major economies, and the worsening terms of trade will mean less support for the euro area economy. Fourth, uncertainty remains high and confidence is falling sharply.

At the same time, the labour market has remained robust, supporting economic activity. Employment increased by more than 600,000 people in the second quarter of 2022 and the unemployment rate stood at a historical low of 6.6 per cent in July. Total hours worked increased further, by 0.6 per cent, in the second quarter of 2022 and have surpassed their pre-pandemic levels. Looking ahead, the slowing economy is likely to lead to some increase in the unemployment rate.

Fiscal support measures to cushion the impact of higher energy prices should be temporary and targeted at the most vulnerable households and firms to limit the risk of fuelling inflationary pressures, to enhance the efficiency of public spending and to preserve debt sustainability. Structural policies should aim at raising the euro area's growth potential and supporting its resilience.

Inflation

Inflation rose further to 9.1 per cent in August. Energy price inflation remained extremely elevated, at 38.3 per cent, and it was again the dominant component of overall inflation. Market-based indicators suggest that, in the near term, oil prices will moderate, while wholesale gas prices will stay extraordinarily high. Food price inflation also rose in August, to 10.6 per cent, partly reflecting higher input costs related to energy, disruptions of trade in food commodities and adverse weather conditions.

While supply bottlenecks have been easing, these continue to gradually feed through to consumer prices and are putting upward pressure on inflation, as is recovering demand in the services sector. The depreciation of the euro has also added to the build-up of inflationary pressures.

Price pressures are spreading across more and more sectors, in part owing to the impact of high energy costs across the whole economy. Accordingly, measures of underlying inflation remain at elevated levels and the latest staff projections see inflation excluding food and energy reaching 3.9 per cent in 2022, 3.4 per cent in 2023 and 2.3 per cent in 2024.

Resilient labour markets and some catch-up to compensate for higher inflation are likely to support growth in wages. At the same time, incoming data and recent wage agreements indicate that wage dynamics remain contained overall. Most measures of longer-term inflation expectations currently stand at around two per cent, although recent above-target revisions to some indicators warrant continued monitoring.

Risk assessment

In the context of the slowing global economy, risks to growth are primarily on the downside, in particular in the near term. As reflected in the downside scenario in the staff projections, a long-lasting war in Ukraine remains a significant risk to growth, especially if firms and households faced rationing of energy supplies. In such a situation, confidence could deteriorate further and supply-side constraints could worsen again. Energy and food costs could also remain persistently higher than expected. A further deterioration in the global economic outlook could be an additional drag on euro area external demand.

The risks to the inflation outlook are primarily on the upside. In the same way as for growth, the major risk in the short term is a further disruption of energy supplies. Over the medium term, inflation may turn out to be higher than expected because of a persistent worsening of the production capacity of the euro area economy, further increases in energy and food prices, a rise in inflation expectations above our target, or higher than anticipated wage rises. However, if energy costs were to decline or demand were to weaken over the medium term, it would lower pressures on prices.

Financial and monetary conditions

Market interest rates have increased in anticipation of further monetary policy normalisation in response to the inflation outlook. Credit to firms has become more expensive over recent months, and bank lending rates for households now stand at their highest levels in more than five years. In terms of volumes, bank lending to firms has so far remained strong, in part reflecting the need to finance high production costs and inventory building. Mortgage lending to households is moderating because of tightening credit standards, rising borrowing costs and weak consumer confidence.

Conclusion

Summing up, we raised the three key ECB interest rates by 75 basis points today, and expect to raise interest rates further, because inflation remains far too high and is likely to stay above our target for an extended period. This major step frontloads the transition from the prevailing highly accommodative level of policy rates towards levels that will support a timely return of inflation to our two per cent medium-term target.

Our future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach. We stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term inflation target.

We are now ready to take your questions.

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Could you give us a flavour of the Governing Council's discussions, the arguments for and against, that led to today's decision to raise rates by 75 basis points and not for example by 50 or 100 basis points?

Then my second question: from the present standpoint how close to both the neutral rate of interest and the expected terminal rate does today's decision bring us, in your view?

I'll take them in turn. On your first question: the Governing Council unanimously decided to raise the three key ECB rates by 75 basis points. We had different views around the table, a thorough discussion but the outcome of our discussion was a unanimous decision. So how did we come to that decision? As I have said before, and as I have repeated in that monetary policy statement, since our last July meeting we are data dependent and operate meeting by meeting. This is the methodology that we adopt. So we were presented by staff with their projection. We had the inflation numbers and the growth outlook, of course. So in the face of these extremely high numbers – the last [inflation] reading was 9.1% [year-on-year] for a monthly reading, but if you look at the last ten readings, they were the last ten highest readings in turn – we had a good analysis of the decomposition of the sources of inflation. A good analysis of where the inflation actually lies and what products are particularly affected.

Of course energy is still the major source of inflation – [energy price inflation is] 38.3% compared with a year ago – slightly moving down in these August numbers, but it is still a dominant factor, as is in the increase in food. But we also have an inflation that spreads across the whole range of products in particular in the service sector, where supply factors are less prevalent and where demand plays a role. So we have a range of products and services that are actually north of 4% [inflation rate]. In the face of an inflation that is extremely high, that is of a magnitude and persistence across sectors of that nature, obviously determined action had to be taken. This is very much in line with our determination to actually normalise monetary policy as we started back in December. So for those who consistently repeat that the European Central Bank is lagging behind, I contend that we are on a journey that started back in December where we decided to put an end to the asset purchases, the PEPP and then the APP, to move out of negative interest rates as we did back in July and now to continue on our normalisation path, with a frontloading exercise that we conducted today, because we believe that the deviation from target is such that it warrants this frontloading. We also decided that this was not an isolated decision, but that we would raise interest rates further. We didn't say that we would raise interest rates by 75 [basis points], as if 75 was the norm; it is not. We will determine meeting by meeting on the basis of data how we reach that level of interest rates which will actually return us to the 2% target in the medium term. It is not there at the moment. Our forecast at the end of December [2024] – which is not the medium term but it's the end of our projection exercise – is at 2.3%. We are not there, so we have more journey to cover going forward.

You were interested in the flavour of the Governing Council meeting; we had a very cordial, effective, deep discussion on all these matters and that certainly helped us on the basis of the proposals by staff